

Message Text

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XMB-02 OPIC-03 LAB-04 SIL-01 L-03 H-01 PA-01
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HEW-04 /108 W

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TO SECSTATE WASHDC IMMEDIATE 4461
INFO AMEMBASSY BONN
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E.O. 11652: N/A
TAGS: ECON, EFIN, PO
SUBJECT: PS/CDS INTERPARTY AGREEMENT: ECONOMIC ANNEXES

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REF: LISBON 523

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BEGIN SUMMARY: THE JANUARY 19 PS/CDS INTERPARTY AGREEMENT HAS
TWO ECONOMIC PORTIONS. THE FIRST, THE ECONOMIC STABILIZATION
PROGRAM, SETS AS ITS GOALS: REDUCE SIGNIFICANTLY BALANCE OF

PAYMENTS CURRENT ACCOUNT DEFICIT; LOWER INFLATION RATE TO ABOUT 20 PERCENT; AND PREVENT AGGRAVATION OF UNEMPLOYMENT SITUATION. STABILIZATION PROGRAM INCLUDES: BALANCED BUDGET CURRENT ACCOUNT, WITH CONSTRAINED OVERALL DEFICIT; CREDIT RESTRAINTS; STIMULATION OF FOREIGN AND DOMESTIC PRIVATE INVESTMENT; INCREASED PRODUCTIVITY; AND PREFERRED CREDIT FOR EXPORT-ORIENTED, IMPORT SUBSTITUTING, AND LABOR INTENSIVE ACTIVITIES. THE SECOND PORTION, THE 1979-84 MEDIUM TERM DEVELOPMENT PLAN, AIMS TO INCREASE GROWTH RATE PROGRESSIVELY, WITHIN STABLE MACRO FRAMEWORK, WHILE ALSO ADDRESSING SOCIAL NEEDS AND PREPARING PORTUGAL FOR EC MEMBERSHIP. PROPOSED POLICIES INCLUDE: INCENTIVES TO FOREIGN AND DOMESTIC INVESTMENT IN KEY DEVELOPMENT SECTORS; REDUCTION OF INTERSECTORAL AND INTERREGIONAL INCOME DISPARITIES; MORE RATIONAL HUMAN RESOURCE MANAGEMENT; AND MODERNIZATION OF TOURISM, DISTRIBUTION, AND TRANSPORT INFRASTRUCTURES.

AGREEMENT OFFERS POSSIBILITY OF A SOUND ECONOMIC STABILIZATION PROGRAM. IT CLEARLY RECOGNIZES EXTERNAL DEFICIT AS NATION'S PRINCIPAL ECONOMIC PROBLEM, WHICH THREATENS SURVIVAL OF PORTUGUESE DEMOCRACY. GOP UNDOUBTEDLY WILL SOON INVITE IMF TO RESUME NEGOTIATIONS OF STANDBY AGREEMENT. END LIMITED OFFICIAL USE.

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1. 1978 STABILIZATION PROGRAM.

(A) PROGRAMS BASIC OBJECTIVES ARE TO:

-- REDUCE BALANCE OF PAYMENTS CURRENT ACCOUNT DEFICIT TO "ADEQUATE" LEVEL.

-- REDUCE INFLATION RATE TO ABOUT 20 PERCENT.

-- CREATE NEW JOBS IN NUMBER SUFFICIENT AT LEAST TO PREVENT AGGRAVATION OF UNEMPLOYMENT RATE.

(B) MEASURES TO ACHIEVE FOREGOING OBJECTIVES INCLUDE:

-- FISCAL POLICY AIMED AT BALANCED BUDGET CURRENT ACCOUNT, ENTAILING HIGHER TAXES AND LOWER TRANSFERS/SUBSIDIES, AND A GLOBAL BUDGET DEFICIT CONSISTENT WITH OVERALL CREDIT POLICY.

-- MORE RESTRICTIVE MONETARY POLICY THAN IN 1977.

-- INVESTMENT POLICY THAT: DISCOURAGES CAPITAL INTENSIVE, HIGH IMPORT CONTENT INVESTMENT, WHILE ENCOURAGING EXPORT-ORIENTED, JOB-CREATING INVESTMENT; STIMULATES PRIVATE INVESTMENT.

-- INCOME POLICY THAT RESTRAINS GROWTH OF WAGE BILL TO ABOUT 20 PERCENT, BUT ALLOWS FOR SOME READJUSTMENT DURING THE YEAR FOR HIGHER THAN ANTICIPATED INFLATION RATE.

-- PRICE POLICY THAT CONTINUES TO REGULATE PRICES "A

POSTERIORI"; PERMITS SUBSIDIES FOR ESSENTIAL
CONSUMER ITEMS; DEFINES PRICING RULES FOR PUBLIC
AND PRIVATE ENTERPRISES, THROUGH ADOPTION OF A

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PRICE CODE; AND ASSURES PROFITABILITY OF PUBLIC SECTOR
ENTERPRISES.
-- LABOR POLICY GEARED TOWARD: BETTER UTILIZATION OF
HUMAN RESOURCES THROUGH GREATER USE OF SHIFTS, PART-TIME
WORK AND BONUSES.

2. MEDIUM TERM PLAN:
(A) ECONOMIC DEVELOPMENT POLICY FOR 1979-1984 WILL SEEK:
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-- PROGRESSIVELY HIGHER GROWTH RATES IN CONTEXT OF MACROECONOMIC AND EXTERNAL EQUILIBRIUM, ALBEIT WITH ONLY MODEST RATES IN EARLY YEARS OF PLAN.

-- IMPROVED RESPONSE TO SOCIAL NEEDS, INCLUDING REDUCTION OF DISPARITIES BETWEEN INCOME GROUPS AND REGIONS.

-- SOCIAL AND ECONOMIC CHANGES THAT WILL PREPARE PORTUGAL FOR EC ENTRY.

B. THE PRECEDING OBJECTIVES ARE TO BE ACHIEVED BY POLICIES THAT WILL:

-- STIMULATE PRODUCTIVITY OF PUBLIC SECTOR ENTERPRISES.

-- ENCOURAGE PRIVATE INITIATIVE.

-- ASSIST COOPERATIVE SECTOR.

-- LEAD TO A CONTRACTUAL FRAMEWORK THAT WILL GOVERN RELATIONS BETWEEN GOVERNMENT AND ENTERPRISES, BOTH PUBLIC AND PRIVATE, WITH VIEW TOWARD FOSTERING GROWTH, STIMULATING EXPORTS, AND CREATING JOBS.

-- RECOGNIZE IMPORTANCE OF FOREIGN INVESTMENT AS SOURCE OF TECHNOLOGY AND FINANCE, WHILE PROTECTING FUNDAMENTAL POSITION OF PORTUGUESE CAPITAL IN THE ECONOMY.

-- PROMOTE EXPANDED INVESTMENTS, ESPECIALLY IN AGRICULTURE, FISHING, AND EXPORT INDUSTRIES.

C. ECONOMIC GROWTH IS TO BE PURSUED IN THE CONTEXT OF POLICIES THAT LEAD TO:

-- BALANCE IN BUDGET'S CURRENT ACCOUNT AND CRITICAL ANALYSIS OF CAPITAL BUDGET DEFICITS.

-- DEVELOPMENT OF INTERNAL CAPITAL MARKETS.

-- MORE EQUITABLE INCOME DISTRIBUTION THROUGH APPROPRIATE INCOMES AND TAX POLICIES.

-- RATIONAL UTILIZATION OF CAPITAL AND HUMAN RESOURCES.

-- BETTER INTEGRATION OF RETURNEES FROM FORMER COLONIES.

-- IMPROVED BASIC AND PROFESSIONAL EDUCATION AND TRAINING.

-- DEVELOPMENT OF NEW EXPORT MARKETS.

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-- INCREASED OUTPUT AND PRODUCTIVITY OF AGRO, FISHERIES, AND CONSTRUCTION SECTORS.

-- RATIONAL DEVELOPMENT OF TOURISM AND TRANSPORT SECTORS.

-- MODERNIZATION OF DISTRIBUTION SYSTEM. END UNCLASSIFIED BEGIN LIMITED OFFICIAL USE.

3. COMMENT: THE PS/CDS ECONOMIC AGREEMENT, WHICH WILL BE THAT BASIS OF THE SECOND CONSTITUTIONAL GOVERNMENT'S ECONOMIC POLICIES, OFFERS THE POSSIBILITY OF A SOUND STABILIZATION PROGRAM. SEVERAL POSITIVE POINTS ARE WORTH

HIGHLIGHTING. OF MOST IMMEDIATE IMPORTANCE, THE TWO PARTIES COMMIT THEMSELVES TO CONCLUDING RAPIDLY AN AGREEMENT WITH THE IMF. THEY REINFORCE THIS COMMITMENT BY STRESSING THE NEED FOR A RESTRICTIVE MONETARY POLICY, RELATIVELY LOW GNP GROWTH IN 1978, AND MARKED IMPROVEMENTS IN PUBLIC ENTERPRISE OPERATIONS. THIS LAST POINT IS ESPECIALLY NOTEWORTHY. THE AGREEMENT DEALS WITH THIS ISSUE IN SPECIFIC TERMS, STATING THAT SUBSIDIES AND TRANSFERS MUST DECLINE, THAT ENTERPRISES MUST RAISE THEIR PRICES IN ORDER TO BECOME PROFITABLE, THAT SHIFT WORK MUST EXPAND, AND THAT PRODUCTIVITY MUST INCREASE. IT CLEARLY AND PUBLICLY ACKNOWLEDGES THAT THE EXTERNAL DEFICIT IS THE NATION'S PRINCIPAL CONDITIONING FACTOR, THAT IT THREATENS THE SURVIVAL OF PORTUGUESE DEMOCRACY, AND THAT AN IMF

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ACCORD IS THE ONLY REALISTIC WAY TO RESOLVE THIS PROBLEM.

4. THE AGREEMENT MAKES SEVERAL PREDETERMINING STATEMENTS ABOUT FUTURE POLICIES. IT UNEQUIVOCALLY ACCEPTS THE LIMITED OFFICIAL USE

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CONCEPT OF AN OPEN MARKET ECONOMY FOR PORTUGAL. FOLLOWING FROM THAT ACCEPTANCE, IT REJECTS GENERALIZED IMPORT RESTRICTIONS; EMPHASIZES THE NEED FOR MORE EXPORTS; UNDERLINES IMPORTANCE OF ACCELERATING INVESTMENT, MENTIONING SPECIFICALLY THE DESIRABILITY OF FOREIGN INVESTMENT; AND PLACES GREATER RELIANCE ON THE PRIVATE SECTOR. MANY OF THESE POLICIES COINCIDE WITH WHAT THE FIRST CONSTITUTIONAL GOVERNMENT HAD PREVIOUSLY ESPOUSED, ESPECIALLY DURING PRIVATE CONVERSATIONS WITH EMBASSY. HOPEFULLY THE SECOND CONSTITUTIONAL GOVERNMENT WILL FEEL SUFFICIENTLY SECURE POLITICALLY TO CARRY THROUGH WITH IMPLEMENTATION.

5. THE AGREEMENT CAREFULLY AVOIDS SOME OF THE MOST DIFFICULT ECONOMIC QUESTIONS. IT MENTIONS CREDIT RESTRAINT, BUT OMITTS REFERENCE TO ANY SPECIFIC TARGETS. IT SIDESTEPS ALSO THE ISSUE SURROUNDING INTEREST RATES, SIMPLYRRR SUBSUMING THIS QUESTION UNDER THE STATEMENT THAT MONETARY POLICY WILL BE MORE RESTRICTIVE THAN IN 1977. UNDOUBTEDLY THE TWO PARTIES WILL HAVE TO CONTINUE DISCUSSIONS ON THESE ISSUES. THOSE DISCUSSIONS, IN TURN, WILL BE HEAVILY INFLUENCED BY THE COURSE OF THE GOP'S NEGOTIATIONS WITH THE IMF.

6. WE SHOULD TAKE THE PROMISE OF AN INFLATION RATE OF 20 PERCENT WITH A LARGE GRAIN OF SALT. GOP'S WELL AWARE THAT INFLATION RATE IN 1978 WILL BE CONSIDERABLY HIGHER. HOWEVER, IT FEELS IT MUST MAINTAIN THE FICTION OF A 20 PERCENT INFLATION RATE IN ORDER TO HOLD THE WAGE BILL INCREASE TO 20 PERCENT.

7. PS/CDS GOVERNMENT WILL LIKELY INVITE IMF DELEGATION TO RESUME NEGOTIATIONS AT EARLIEST LIMITED OFFICIAL USE

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POSSIBLE OPPORTUNITY. DESPITE SOME FLAMBOYANT
STATEMENTS ABOUT BEGINNING THESE DISCUSSIONS AFRESH, GOP
ECONOMISTS UNDERSTAND THAT NEGOTIATIONS MUST RESUME
WHERE THEY RECESSED LAST NOVEMBER. EMBASSY BELIEVES
THAT, ALTHOUGH DIFFICULT NEGOTIATIONS LIE
AHEAD, GOP AND IMF SHOULD NOW BE ABLE TO CONCLUDE
AN AGREEMENT.
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